In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 743

INDIANA BROADCASTING CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

In November 1956 petitioner acquired all the assets of two television stations in Indiana for approximately $11,100,000. Both stations were affiliated with the Columbia Broadcasting System and had entered into the usual industry contracts with CBS which (pursuant to FCC rule) have an initial duration of two years with automatic renewel for additional two-year periods, subject to termination only on specified written notification. Both affiliation contracts had been renewed only a few months before the acquisition and thus had nearly two years to run. CBS consented to the transfer of the affiliation contracts to petitioner.

The Tax Court found that of the approximately $11,000,000 paid by petitioner for the two stations,

$4,625,000 was allocable to the two affiliation contracts, and, on the basis of a statistical study of the duration of other television network affiliation contracts, the Tax Court also found that petitioner's two contracts had a life expectancy of 20 years. The Tax Court thus allowed petitioner to deduct the price it had paid for the contracts as depreciation over a period of 20 years. The court of appeals reversed, stating that the contracts had either a "perpetual duration" or "a wholly unpredictable life" and thus were not depreciable. (Pet. 4a-16a, 4-5.)

The decision of the court of appeals is clearly correct, presents no conflict of decisions, and in any event involves primarily a factual determination which does not warrant review by this Court.

1. The Code permits a taxpayer to deduct a "reasonable allowance for the exhaustion, wear and tear" of property used in a trade or business or for the production of income. 1954 Code § 167(a). The Regulations have long provided that an intangible asset may be depreciated only if it "is known from experience or other factors to be of use in the business * * * for only a limited period, the length of which can be estimated with reasonable accuracy." [1]

[1] Treas. Reg. § 1.167(a)-3 provides:

> If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance. Examples are patents and copyrights. An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. No al-

The allowance for depreciation is designed to reflect the financial consequences to the taxpayer of the subtle effects of time and use on the value of his capital assets and is confined to property which gradually approaches a point where its usefulness is exhausted. *United States* v. *Ludey*, 274 U.S. 295; *Detroit Edison Co.* v. *Commissioner*, 319 U.S. 98. Thus, depreciation is allowed only where there is some relationship between the passage of time and the diminution in the value of the asset involved. No such deduction will be granted with respect to an asset (*e.g.*, corporate stock or good will) which, although it might at some indeterminate future date cease to be of value, has no reasonably predictable useful life. *Nachman* v. *Commissioner*, 191 F. 2d 934 (C.A. 5th).

For example, a taxpayer who purchased stock in a speculative mining venture for $10,000 would not be permitted to depreciate his investment over 10 years, even if he proved by a statistical analysis that 10% of the companies of that nature failed annually. Similarly, a taxpayer who, in purchasing a business, paid $10,000 for good will could not depreciate that asset over 20 years, even if he showed that 5% of such businesses failed each year. Neither the stock in the mining venture nor the good will have any reasonably ascertainable life; in fact, there is no relationship between the passage of time and the value of such assets. There is no reason to believe that either

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lowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life. No deduction for depreciation is allowable with respect to good will. * * *

will be worth less instead of more at the end of 10 years or 20 years than they were at the time of purchase. The purely speculative possibility that a business will fail (or that the network contract here in question will be cancelled) is not sufficient grounds for allowing depreciation. The court of appeals correctly found that the network affiliation contracts here in question, "unlike an asset having a declining value with the passage of time, * * * probably will have a constant value, or even an increasing value, in years to come" (Pet. 15a).

2. Moreover, even if such an asset could in some circumstances be depreciated, the court of appeals was correct in holding that the Tax Court was clearly erroneous in finding, on the basis of petitioner's statistical evidence, that the affiliation contracts here in question had a "limited" life which could be "estimated with reasonable accuracy" (Treas. Reg. § 1.167(a)-3) at 20 years.

Petitioner and the Tax Court relied heavily upon a statistical study of television network affiliation contracts which terminated between 1948 and 1962. According to petitioner's experts, this study showed that the arithmetical average life of such contracts was 20 years. The court of appeals correctly found that those figures were manifestly unrepresentative of petitioner's situation for at least two reasons:

(a). The court of appeals found that petitioner's statistics related mainly to the period of television's infancy, a period marked by instability and general flux, that most of petitioner's statistics concerned network affiliation contracts that had been in force a

relatively short time, and that the longer such a contract has been in effect the less likely it is to be cancelled.[2] Thus it concluded that petitioner's statistical data did not provide a reasonable norm for predictions of the future: "any such norm built upon the evidence in this case would be pure guesswork" (Pet. 12a).

(b). The court of appeals also found that even if petitioner's statistics were accepted as representative, they prove nothing more than that on an industry-wide basis the life of CBS affiliation contracts will average 20 years. If this case dealt with items possessing uniform characteristics, such as vacuum tubes or glass tumblers,[3] such statistics might well be meaningful guides in estimating the probable life of any one unit. But television stations, and their affiliation contracts, are not fungible. The record discloses various factors which CBS considers significant in deciding whether or not to renew an existing affiliation. First, preference is generally given to an existing affiliation; "unless the new station shows substantial superiority in significant areas, the fact of present affiliation controls."[4] Consideration is also given

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[2] As noted by the court of appeals (Pet. 13a), the evidence showed that CBS has terminated only one contract which was in existence for over nine years, and in that case the station had been affiliated with both CBS and NBC in an area in which CBS already had contracted an exclusive affiliation with another station.

[3] These were cited by taxpayer's expert witness as typical of the items to which the Poisson Exponential Theory of Failure is normally applied. (R. 161.)

[4] Ex. 28, Criteria Governing Choice Among Stations, R. 61, 62. "R." references are to the Joint Appendix filed by the

to the station's past record in giving priority to network programs; the qualifications of its management, including newspaper ownership of a station, experience in the broadcasting business, and such intangibles as "the character, reputation, and integrity of the management"; the location of the station in the most densely populated community of its market area; and various other "intangible and psychological factors" (*Id.*, pp. 63-66).

In contrast to the stations which form the basis for petitioner's study of network terminations, which may have had a shaky financial structure, inexperienced personnel, no operating connections with other stations or newspapers, and a location far from the projected population center of its market area, the facts of record demonstrate that the probability that petitioner's CBS contract would be terminated are so exceedingly remote as to defy statistical calculation, and especially by reference in part to the experience of other, inherently less stable contractual relationships. For example, the record discloses the following (Pet. 14a-15a): Petitioner is managed by experienced persons in the field.[5] It is owned in common

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parties in the court of appeals.

One of the reasons for granting preference to present affiliates is the fact that "viewers tend to associate the Network's programs with the existing affiliate in the community." (Ex. 28, R. 62.) It follows that the longer the affiliation, the stronger the viewer association, and, consequently, the greater the reluctance of the network to terminate the affiliation.

[5] Witnesses for both petitioner (R. 139) and the Commissioner (R. 223) testified that taxpayer's management group is prominent in the industry.

with the New York Herald-Tribune and three other corporations operating television stations in Tulsa, Houston and Sacramento. Its stations are located in the principal cities of their market areas. The stations have a record of broadcasting network programs about 63 percent of total broadcast time and 95 percent of "prime time" hours.[6]

As petitioner states, the useful life of an asset often is susceptible of reasonable estimates on the basis of "the general experience in the industry" (Pet. 31). But where this is so, it is because the factors which influence the length of the useful life are present in substantially the same degree in all such assets in the industry. Here, however, petitioner has not shown that the assets being relied upon to prove a useful life are comparable to petitioner's particular asset. Statistical averaging of industry-wide experience is thus plainly not helpful in estimating the life of the single item here in question with anything approaching "reasonable accuracy."

3. The decision of the court of appeals is in accord with those of other circuits dealing with renewable contracts, and no conflict is presented. *Nachman* v. *Commissioner*, 191 F. 2d 934 (C.A. 5); *Westinghouse Broadcasting Co.* v. *Commissioner*, 309 F. 2d 279 (C.A. 3), certiorari denied, 372 U.S. 935; *Gant* v. *Commissioner*, 263 F. 2d 558 (C.A. 6); *KWTX*

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[6] Also, taxpayer operates CBS-affiliated radio stations in both Indianapolis and Fort Wayne. CBS recognizes that ownership of radio stations in general is a plus factor, insofar as it enhances "station management's character, broadcasting experience, and ability" (R. 66).

Broadcasting Co. v. *Commissioner*, 272 F. 2d 406 (C.A. 5); *Richmond Television Corp.* v. *United States*, 16 AFTR 2d 6109 (decided Dec. 20, 1965, C.A. 4).

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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